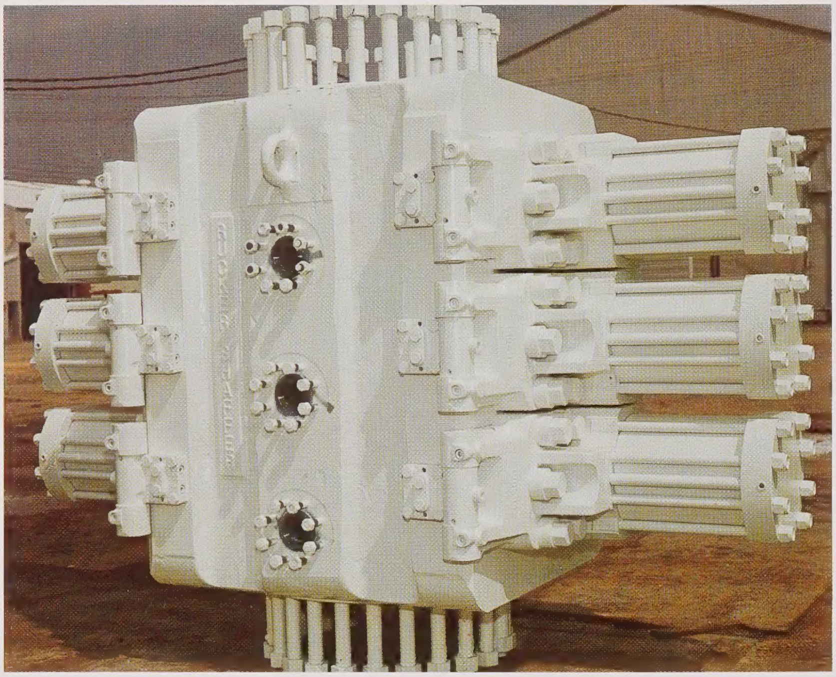
Hawker Siddeley Canada LTD.

1977 annual report

First-class passenger coaches designed and built by Canadian Car Division on their arrival in Mexico prior to entering inter-city service with Ferrocarriles Nacionales de Mexico.



Canadian Steel Foundries Division poured the 40-ton casting for this shut-off unit, a major component in a blow-off preventer stack used in offshore drilling operations as an undersea safety device.

The TB600 twin-boom mining machine developed by Dosco Overseas Engineering Limited is ruggedly constructed for development or production work associated with the mining of coal, iron ore, phosphates, gypsum, potash and other sedimentary rocks.

Contents

Financial Data

	1977	1976	1975	1974	1973
Summary of operations (thousands of dollars)					
Revenue:					
Sales	$362,689	335,081	365,234	325,015	253,628
Income from investments	1,235	695	331	682	489
	363,924	335,776	365,565	325,697	254,117
Costs and expenses:					
Cost of sales, selling, general and administrative expenses exclusive of the following	320,678	301,896	324,140	290,023	225,730
Interest	4,139	6,529	7,713	6,626	4,433
Depreciation and amortization	10,959	10,477	9,915	8,933	8,907
	335,776	318,902	341,768	305,582	239,070
Income from operations before taxes	28,148	16,874	23,797	20,115	15,047
Income taxes	13,200	8,070	11,311	9,889	7,261
Interest of minority shareholders	1,246	1,266	1,014	963	1,585
	13,702	7,538	11,472	9,263	6,201
Exchange gain (loss)	2,624	(1,187)	(1,125)	(2)	3
Income before extraordinary items	16,326	6,351	10,347	9,261	6,204
Extraordinary items	(2,586)	653	1,516	545	1,721
Net income for the year	$ 13,740	7,004	11,863	9,806	7,925
Per common share					
Income before extraordinary items	$ 1.91	.68	1.17	1.04	.66
Net income	1.59	.76	1.36	1.11	.88
Dividends declared	.37	.36	36	.32	.20
Equity	12.74	11.52	11.12	10.12	9.33
Other statistics (thousands of dollars)					
Dividends					
— preferred shares	$ 805	805	805	805	805
— common shares	3,008	2,927	2,927	2,601	1,625
Working capital	55,836	48,607	45,353	37,916	37,169
Capital expenditures					
— Railway rolling stock leasing fleet	3,401	791	14,898	11,582	7,533
— Other	9,289	8,132	11,259	12,276	5,875
Shareholders' equity					
— preferred shares	14,000	14,000	14,000	14,000	14,000
— common shares — share capital	54,320	54,320	54,320	54,320	54,320
— retained earnings	49,262	39,335	36,063	27,932	21,532
Other share data					
Shares issued and outstanding					
— preferred	140,000	140,000	140,000	140,000	140,000
— common	—	—	8,129,341	8,129,341	8,129,341
— common class "A" convertible	7,755,555	7,885,812	—	—	—
— common class "B" convertible	373,786	243,529	—	—	—
Number of shareholders					
— preferred	1,408	1,465	1,540	1,583	1,636
— common	—	—	8,692	8,683	8,729
— common class "A" convertible	7,816	8,141	—	—	—
— common class "B" convertible	141	128	—	—	—
Principal Shareholder — Hawker Siddeley Group Limited percentage holdings					
— preferred	41.79%	41.79%	41.79%	41.79%	41.79%
— common	59.25%	59.25%	59.25%	59.25%	59.25%

Note: The years 1973 to 1975 have been restated to conform with the exchange presentation adopted in 1976.

To the Shareholders

Your Directors submit herewith the audited accounts of Hawker Siddeley Canada Ltd., and its subsidiary companies for the year ended December 31, 1977.

1. Financial

1.1 Sales

Consolidated sales were $362 million ($335 million — 1976) including direct exports of $86 million ($61 million — 1976). Information concerning export sales and the sales volume of foreign subsidiaries is given on page 18 of this report. The distribution of consolidated sales by broad classes of business is shown in Note 2 to the financial statements.

1.2 Income

Income from operations before an extraordinary item was $16.326 million ($6.351 million — 1976) equivalent to $1.91 for each of the outstanding Class A and Class B common shares (68 cents per share — 1976). Net income was $13.740 million ($7.004 million — 1976) equal to $1.59 per common share of each class (76 cents per share — 1976).

1.3 Extraordinary Item

A provision of $2.586 million (after a deferred tax credit of $1.614 million) has been made in the accounts for the cost of a number of reorganization programs including Halifax Shipyards.

1.4 Other Financial Matters

Income for the year includes an exchange gain of $2.624 million (Loss $1.187 million — 1976). The 1977 exchange gain and corresponding 1976 exchange loss arise from translation of the book amount of net assets of foreign subsidiaries to Canadian dollars at the approximate rates ruling at the respective year ends.

1.5 Dividends

In 1977 the Company declared and paid the four quarterly preferred share dividends as they became due.

For the Class A and Class B convertible common shares a dividend of 10¢ was declared payable January 20, 1978 to holders of each class of common share of record December 30, 1977, following declaration and payment of three quarterly dividends of 9¢ per share.

Shareholders should note that amendments to the Income Tax Act (Canada) enacted in December 1977 terminate the right of holders of Class B shares to defer taxation on dividends paid on these shares after 1978.

2. Directors

On May 27, 1977 Mr. R.G. Smith, a Director and Vice-Chairman of the Company, having attained the age limit prescribed by the By-Laws retired from the Board and was succeeded as a Vice-Chairman by Mr. J.N. Paterson. On the same date, Mr. A.H. Crockett was elected a Director of the Company.

3. Comments

Conditions during the year in many respects were similar to those of 1976, when the general sluggishness of the economy had widespread effect. There was a modest improvement in total order intake, but demand was weak in several sectors and competition generally much more intense.

Full utilization of facilities at the Company's passenger rail car plant, Thunder Bay, and the U.K.-based mining equipment plant contributed to the very good results produced at both locations.

The Divisions engaged in the manufacture of forestry and sawmill products benefited from a small but gradual market improvement in that sector and their results were appreciably better than last year. The Divisions producing castings, steel wheels and aerospace components also performed well, even though their markets were far from buoyant. A steady level of earnings was maintained by the Company's 55%-owned tank car leasing subsidiary.

On the other hand the market for railway freight cars, highway trailers and steel structures for electric transmission was extremely poor and the Divisions involved had a difficult year with results that did not meet expectations. It was also an extremely difficult period for the Halifax Shipyards Division which was primarily engaged in completing the last of a series of offshore drilling vessels which have been under construction over the last ten years.

Improvement in the liquidity position of the Company resulted in significantly lower borrowing costs. Net income included an exchange gain which arises from the translation of the book amount of net assets of foreign subsidiaries into Canadian dollars.

In light of the continued depressed state of shipbuilding the Company has concluded that it should discontinue further new construction activity at Halifax and direct the on-going operation towards ship repair. It has also concluded that production of highway trailers should be phased out in favour of optimizing the parts and service business carried on at branch facilities located in several eastern Canadian cities.

A provision against the 1977 consolidated income amounting to $4.2 million ($2.586 million after deferred taxation credits) has been made under 'extraordinary Item 1.3' to cover costs of these and other minor reorganizations.

Turning to the year ahead, there is concern with the continued lack of buoyancy apparent in many of our main trading areas and although we entered the year with a significant order position, it remains unevenly balanced relative to productive capacities. There are also the potential difficulties in concluding new labour contracts scheduled for renewal at a number of operations this year. These factors may have a bearing on the development of period earnings but we are hopeful we can continue to respond favourably to new business opportunities and sustain a suitable working climate. The programs of rationalization, new investment in plant and machinery, as well as the development of markets and products are expected to improve prospects.

The Directors wish to record their thanks to all whose efforts have contributed to the year's results.

Submitted on behalf of the Board

A.A. Hall
R.S. Faulkner

Toronto, Ontario, March 17, 1978.

Comments on Operations

HAWKER SIDDELEY CANADA LTD.

Canadian Car Division

This Division has a strong order book and is now engaged solely in the design and manufacture of railway passenger cars. It operated at near capacity and had a particularly successful year.

The 134 car order for the Toronto Transit Commission's new Spadina line was completed and 140 second-class and 25 first-class coaches of the 200 ordered by Ferrocarriles Nacionales de Mexico were delivered by year end. In addition, production of 80 commuter cars for the Toronto Area Transit Operating Authority commenced during the year and the first train set of cars was completed. These cars can seat 162 passengers on two full decks plus intermediate level compartments at the car ends. With other unique features, designed to improve passenger comfort and convenience and to reduce operating costs, they bring a new dimension to high density commuter travel. The cars are expected to go into service on GO Transit's Lakeshore route through Toronto early in 1978. Preparatory work for the construction of 190 mass transit cars for the Massachusetts Bay Transportation Authority, Boston, was also well advanced by the end of the year.

The major new contract obtained in 1977 was for 190 light rail vehicles designed by the Urban Transportation Development Corporation for operation by the Toronto Transit Commission. The value of this order is approximately $40 million which together with other work in hand will ensure a good level of plant activity through 1978.

Market prospects for new business, however, are not as plentiful as they were several years ago and most developments maturing in new rail and transit systems are in the export field and where intensified competition is likely to prevail. Nonetheless, we are pursuing each opportunity aggressively.

Canadian Car (Pacific) Division

Demand for the Division's Chip-N-Saw line of sawmill products showed a little improvement over the year, on the other hand, spare part sales and computerized control systems were in much stronger demand. Results as a whole improved but continue to reflect an under-utilization of plant and facilities. Among the major deliveries of machines to domestic customers were 11 Chip-N-Saw units, three edge chippers, three vertical arbor edgers and a range of related equipment. Eight machines of various types were sold to U.S. sawmills and others to the Philippines and Sweden.

Consistent with the Division's long-term plans it pursued an active research and development program and a variety of new machine designs and processes have been further advanced. Those showing most promise involve sugar cane processing, wafer board manufacture and high speed drilling and coring using sound dynamics principles.

The outlook for sawmill products is for steady progress with continued strength in other areas. The year ahead for the Division, however, will be enhanced by a contract valued at approximately $20 million for the manufacture of 124 edge-banding and finishing machines for the USSR. These highly sophisticated, electronically-controlled machines finish and apply plastic or veneer edging to plywood used in furniture, door, and countertop manufacture. Delivery of the completed machines is scheduled over a two-year period commencing early in 1978.

The strength of the U.S. and domestic economies, particularly as they relate to new capital investments and housing starts, will continue to have a significant bearing on demand for the Division's traditional product lines. There is optimism that a more buoyant situation lies ahead.

Can-Car Trailer Division

The highway trailer business did not have a satisfactory year. Market conditions improved slightly, but as a whole the demand for new trailers was considerably below industry capacity and this had a significant bearing on pricing and the scheduling of mix on a desirable basis.

This over-capacity situation in recent years has been aggravated by the influx of U.S. manufactured units and while the disparity between the U.S. and Canadian dollar has more recently stemmed this trend, it is of increasing concern to the industry. Production of highway trailers is, therefore, to be phased out in favour of optimizing the parts and service business.

Branch operations of the Division concentrating mainly on service and spare parts sales had, as expected, better results than the year previous.

Canadian Steel Foundries Division

The year started well at the Foundry but order intake tapered off so that business for the year was distinctly down from that of 1976. The absence of new railway freight car building programs in Canada was the

prime reason for the low requirements for railway castings and replacement parts made up the bulk of the sales in this category. In the industrial category, seven hydraulic turbine runners, each weighing 128 tons, for the James Bay Power Project, two 120-ton sets of steam turbine casings, pump casings, and kiln rings for the mining industry were among some of the larger tonnage items which provided a steady level of activity. The volume of medium to small castings, particularly in minewear and valve housings, also provided useful loading but the deferment of nuclear station programs particularly in the United States continue to affect the market for high integrity castings in which the Division has established itself in recent years. Competition for all categories of work was severe and influenced profit margins on available business.

Modernization programs were continued throughout the year, improving sections of the Foundry and expanding the range of castings which can be poured. These programs enhance the reputation already accorded the Division for quality products and supplement programs of previous years which have steadily improved environmental and working conditions and contributed to better plant performance. High levels of efficiency were maintained throughout the year and this played an important part in the results achieved.

Increased bidding activity in recent months is, hopefully, an indication of an early market upturn. The Division is extremely well placed to compete on a wide range of casting requirements.

Canadian Steel Wheel Division

Strong demand for railway wheels as replacement items more than offset the decline in requirements for wheels for new rolling stock resulting from the absence of significant car orders in the industry. Export markets for railway wheels were difficult to penetrate against severe overseas competition and sales were restricted largely to the United States. Demand for industrial wheels, which do not normally account for a significant portion of total production, remained depressed. The Division was successful, however, in securing a valuable order for production of steel ingots which enhanced facility utilization and favourably improved results.

A major capital program directed towards generally improving plant efficiency and environmental conditions was substantially completed. A new fully automated machining line is scheduled to come into production early in 1978.

The lack of new freight car orders will continue to affect immediate demand. However, based on the normal demand levels of the wheel replacement market and export possibilities which we continue to pursue actively, we expect to maintain a good level of plant activity in the course of the coming year.

Forestry Equipment Division

Sales of equipment produced by the Division, principally various models of "Tree Farmer" log skidders and forwarders, were ahead of 1976 reflecting the modest strengthening taking place in the forest products industry, particularly in the United States.

Production of machines started at new facilities in Mississauga, Ontario, at the beginning of 1977 following the transfer of manufacturing and support operations from Thunder Bay. Overall progress was satisfactory and a renewed basis for the business has been established.

Several important improvements were made to the product line and the prototype of a new skidder model was completed and tested. The distribution network was strengthened in the United States and in Canada where new marketing arrangements in British Columbia resulted in improved sales of the heavier Tree Farmer models in that area.

The Division continued to explore new applications for the basic Tree Farmer unit as an off-highway, all-terrain vehicle. Three machines were supplied for the addition of firefighting equipment and subsequent export to Senegal where they were to be used against brushwood and forest fires.

The outlook for the Division in the year ahead is for a steady increase of its activities and improved results.

Orenda Division

Orenda experienced a favourable upturn in business mainly related to repair and overhaul of J79 and J85 aircraft jet engines for the Canadian Armed Forces and provision of related spare parts and components. A useful contribution was also obtained from ongoing sub-contract work on parts for a U.S. aircraft engine builder and the manufacture of nuclear components for Atomic Energy of Canada Limited. The latter high-technology work included the fabrication of light water zone control rods, injection nozzles and absorber rods for installation in nuclear power stations and Candu reactor export packages.

On the industrial gas turbine side, the main activity was related to the supply of substantial quantities of spare parts and the repair and overhaul of a number of gas generators. In the course of the year an order

was received for the supply of six OT 390 gas turbine units for use in standby generating sets in the extension of Ontario Hydro's nuclear power station at Pickering. Similar Orenda units are installed in the first phase of this station.

The outlook on anticipated levels of aircraft engine repair and overhaul work, indicates a busy year ahead. For the longer term prospects, the Division is actively pursuing opportunities to participate in the Government's recently announced fighter replacement program.

HAWKER INDUSTRIES LIMITED
(Approx. 99% owned)

Canadian Bridge Division

This operation suffered from a series of problems in the course of the year which, added to an extremely low volume of work in its main tower component fabrication shop, seriously affected results.

Stiff competition and price cutting was prevalent in the industry for most of the year and some large contracts were lost to competitors. In addition, there was a significant drop-off in business of a more regular nature.

Log skidder chassis fabrication work for the Forestry Equipment Division was transferred to Canadian Bridge with the aim of reducing the plant's vulnerability to the cyclical demands of the tower business.

By the end of the year, most of the difficulties were being overcome and in the interim the order position has strengthened to a point where distinctly better results are expected for 1978.

Halifax Shipyards Division

Following completion early in the year of a semi-submersible offshore drilling vessel Sedco 709, the main activity at Halifax related to the construction of a drill ship Sedco 471.

This vessel, while having a conventional hull form, is designed to operate as a self-sufficient unit and perform drilling operations in exceptionally deep waters. Among the many advanced technical features installed aboard this vessel is its full dynamic positioning capability. She is scheduled to begin operation in the North Sea early in March and is the eighth and last drilling vessel to be constructed at Halifax since the program began some ten years ago.

Ship repair activity maintained a good pace at the Halifax Yard whereas activity levels at the smaller Dartmouth-based Yard were lower than average. Competition for available repair work was intense and pricing in many instances was unrealistic. The Dartmouth operation also was affected by its reduced docking capability pending installation of a new 3,000 ton cradle.

In light of the continued depressed state of shipbuilding the Company has concluded that it should discontinue further new construction activity at Halifax and direct the on-going operation towards ship repair.

Trenton Works Division

Very low demand for new freight cars by the domestic railways resulted in the lowest volume of business for the Division for several years. Rail car building facilities were severely under-utilized and in the first quarter there was a total absence of production. In the balance of the year only 688 new units were produced, all of them grain cars for the Canadian Wheat Board, together with a small number of tank cars. Freight and tank car repair work provided some additional and useful business.

The tonnage produced of large forgings showed a slight improvement over the previous year and included shafts for ships, industrial fans and generators, heavy water plant components, and hydraulic press cylinders. Axle manufacture suffered from the lack of new car orders in our own and other car-building plants and a significant portion of the available business was secured by offshore suppliers at unrealistic prices.

The year ahead is also likely to be difficult as domestic railway purchases of new cars are expected to be minimal. It is hoped that the Company's initiatives in export markets in recent years will continue to provide useful opportunities and offset the severe cycling of demand by domestic railways. At the end of the year we had an order for 439 freight cars for Zambian railways made up of hopper cars and two types of gondola cars, and were preparing to build 100 air dump cars for CN/CP. Prospects for additional work are encouraging and are being actively pursued.

Dosco Overseas Engineering Limited

Volume of sales increased for this U.K.-based subsidiary and results generally achieved satisfactory levels, although the number of mining and tunnelling machines produced was less than in the previous year.

The main market for Dosco machines remained in the U.K. domestic sector, the major customer being the National Coal Board. Notable among the deliveries in

1977 was an SB600 circular tunnelling machine for opening up the new mine complex at Selby, Yorkshire, which eventually will be among the largest in the world.

Significant penetration of export markets was achieved with repeat business to Spain, the United States, Australia, Mexico and Romania and initial sales to other countries. In the latter group tunnelling machines for coal mine operations were supplied to Argentina, Italy, Hungary and Brazil.

Trials of the new TB600 twin-boom mining machine were completed during the year. The machine is designed specifically for cutting the harder minerals and ores. Two units are to be put in service early in 1978 in France and California, where they will be employed in iron ore and borate mining operations respectively. Development work was also carried out on a variety of new machines and systems directed towards the mining market.

A further improvement in results was also shown by Hollybank Engineering Company Limited. This subsidiary of Dosco Overseas Engineering Limited manufactures various types of supports and related components for mine roadways and tunnels and is also a major supplier to the National Coal Board.

Towards the end of the year, the Head Office of both Dosco Overseas and Hollybank was moved from Aylesbury to the factory site at Tuxford. This completes a major stage of expansion and consolidation of facilities to accommodate the rapid growth of the operations.

The companies expect to have another busy year ahead with markets generally remaining firm.

CANADIAN GENERAL TRANSIT COMPANY, LIMITED (55% owned)

This company's diversified fleet of rail cars, which is leased primarily to users in the petroleum, chemical and food industries, was again utilized almost to full capacity. The demand for new cars, on the other hand, continued to be adversely affected by the lull in the economy, a situation which also extended to the operation of the company's bulk liquid storage terminals located in Montreal and Toronto. The volume of products handled at these terminals was significantly down from the previous year.

The company's maintenance depots located in Montreal, Moose Jaw, and Red Deer, had increased volume of repair and service business for other operators, as well as for the company's own fleet.

In the year ahead, fleet utilization is expected to remain high and indications are that a new cycle of requirements for cars of all categories could become evident as the year progresses.

Hawker Siddeley Canada Ltd. and Subsidiary Companies

Consolidated Statement of Income and Retained Earnings

for the year ended December 31, 1977

	1977	1976
	(in thousands)	
Revenue:		
Net sales (Note 2)	[illegible]	$335,081
Income from investments	1,235	695
	363,924	335,776
Costs and expenses:		
Cost of sales, selling, general and administrative expenses exclusive of the following	320,678	301,896
Interest on short term borrowings	[illegible]	2,253
Interest and amortization of costs of long term debt	3,778	4,276
Provision for depreciation	10,659	10,177
Amortization of patents (Note 5)	300	300
	335,776	318,902
Income from operations before income taxes	[illegible]	16,874
Provision for income taxes — current	9,440	4,805
— deferred (Note 10)	3,760	3,265
	13,200	8,070
	14,948	8,804
Interest of minority shareholders in income of subsidiaries	1,246	1,266
	13,702	7,538
Exchange gain (loss) on the translation of the accounts of foreign subsidiaries	2,624	(1,187)
Income before extraordinary items	16,326	6,351
Special provision (Note 11)	(2,586)	—
Income tax provision not required	—	653
Net income for the year	13,740	7,004
Retained earnings, beginning of year	39,335	36,063
	53,075	43,067
Dividends — preferred shares	805	805
— common shares	3,008	2,927
	3,813	3,732
Retained earnings, end of year	[illegible]	$ 39,335
Income per common share after preferred dividends (Note 9):		
Before extraordinary items	[illegible]	68¢
After extraordinary items	[illegible]	76¢

Hawker Siddeley Canada Ltd. and Subsidiary Companies

Consolidated Balance Sheet

December 31, 1977

ASSETS	1977	1976
	(in thousands)	
Current Assets:		
Cash and short term bank deposits	$ 20,487	$ 18,293
Accounts receivable	60,659	51,605
Income taxes recoverable	—	2,043
Inventories, less progress payments	69,284	59,841
Prepaid expenses	1,986	1,520
	152,416	133,302
Investments, at cost (Note 3)	3,223	3,266
Fixed Assets, at cost (Note 4)	267,063	255,809
Less: Accumulated depreciation (Note 11)	134,010	123,063
	133,053	132,746
Other Assets, at cost less amortization:		
Patents (Note 5)	—	300
Issue costs of long term debt	312	340
	312	640
	$289,004	$269,954

Approved by the Board:

A.A. Hall, Director

R.S. Faulkner, Director

LIABILITIES AND SHAREHOLDERS' EQUITY

	1977	1976
	(in thousands)	
Current Liabilities:		
Bank advances	$ 2,365	$ 14,462
Accounts payable and accrued liabilities	56,245	46,403
Dividends payable	1,014	933
Income and other taxes payable	15,171	8,764
Advances on sales contracts	13,005	6,958
Long term debt due within one year (Note 7)	4,810	3,445
Owing to affiliated companies (Note 6)	3,970	3,730
	96,580	84,695
Long Term Debt (Note 7)	35,357	40,167
Provision for Unfunded Pensions (Note 8)	4,010	4,465
Deferred Income Taxes	22,698	20,550
Minority Interest	12,777	12,422
Shareholders' Equity:		
Preferred and common shares (Note 9)	68,320	68,320
Retained earnings	49,262	39,335
	117,582	107,655
	$289,004	$269,954

Hawker Siddeley Canada Ltd. and Subsidiary Companies

Consolidated Statement of Changes in Financial Position

for the year ended December 31, 1977

	1977	1976
	(in thousands)	
Source of working capital:		
Income before extraordinary items	$16,326	$ 6,351
Charges to income not affecting working capital — (mainly depreciation, amortization of patents, deferred income taxes and interest of minority shareholders in income of subsidiaries)	14,629	14,127
Working capital provided from operations	30,955	20,478
Proceeds on disposal of fixed assets	1,262	1,111
Income taxes recovered in extraordinary item	—	653
Miscellaneous	35	31
	32,252	22,273
Application of working capital:		
Additions to fixed assets —		
Railway rolling stock leasing fleet	3,401	791
Other	9,289	8,132
Special provision (Note 11)	2,370	—
Reduction of —		
Long term debt	4,810	5,166
Provision for unfunded pensions (Note 8)	455	388
Dividends declared payable to —		
Shareholders of Hawker Siddeley Canada Ltd.	3,813	3,732
Minority shareholders of subsidiaries	885	810
	25,023	19,019
Working capital:		
Increase for the year	7,229	3,254
At beginning of year	48,607	45,353
At end of year	$55,836	$48,607

Changes in Elements of Working Capital

	1977	1976
Current assets — Increase (decrease):		
Cash and short term bank deposits	$ 2,194	$13,708
Accounts receivable	9,054	(181)
Income taxes recoverable	(2,043)	2,043
Inventories	9,443	(25,895)
Prepaid expenses	466	496
	19,114	(9,829)
Current liabilities — Increase (decrease):		
Bank advances	(12,097)	(1,331)
Accounts payable and accrued liabilities	9,842	(8,016)
Dividends payable	81	—
Income and other taxes payable	6,407	2,317
Advances on sales contracts	6,047	(5,406)
Long term debt due within one year	1,365	(998)
Owing to affiliated companies	240	351
	11,885	(13,083)
Increase in working capital for the year	$ 7,229	$ 3,254

Notes to Consolidated Financial Statements

for the year ended December 31, 1977

1. Summary of principal accounting policies:

Principles of consolidation —
The consolidated financial statements include the accounts of Hawker Siddeley Canada Ltd. and all subsidiary companies.

Foreign currency translation —
Assets and liabilities in foreign currencies have been translated at year-end rates of exchange except for investments and long term debt. Investments have been translated at rates of exchange in effect when they were acquired. Long term debt has been translated at rates of exchange in effect when the obligations were incurred or when determined by forward foreign exchange contracts.

Translation adjustments are charged or credited to current income.

Revenue recognition —
Revenue is recorded at the time the product is shipped or the services performed except on long term contracts. Revenue on long term contracts involving a series of shipments (for example railway or rapid transit cars) is recorded as cars are accepted by the customer. Revenue on long term contracts involving a single product (for example an oil drilling vessel) is recorded on the percentage of completion method. Losses, if any, are provided for in full as soon as they become evident.

Research and development costs —
These costs are expensed as incurred.

Product warranty costs —
Anticipated costs related to product warranty are provided at the time of the sale of the products.

Costs of long term debt —
Commission costs incurred on issue of long term debt are amortized over the term of the debt issue to which they relate.

Cost of patents and rights for new products —
Significant costs incurred in purchasing patents and rights for products are amortized on the straight-line method over the lesser of the period of anticipated or legal advantage. Other costs relating to patents and rights are expensed as incurred.

Inventories —
Inventories are carried at the lower of cost and net realizable value, less progress payments.

Fixed assets —
Fixed assets are carried at cost. Depreciation on these assets is provided over their estimated useful lives primarily on the straight-line basis at rates of 2½% on buildings, 10% generally on equipment and 4% on railway rolling stock.

Pensions —
The Company and its subsidiaries have pension obligations to unfunded and funded pension plans.

Obligations to unfunded plans relate to retired employees and certain current employees for benefits which, for the most part, arose before the establishment of funded pension plans. The principal obligation for unfunded pension plans is in Hawker Industries Limited, having originated in 1923. Under these pension plans monthly payments are made to pensioners which are charged, after appropriate income taxes, to the provision established for that purpose.

Obligations to funded pension plans relate to present, retired and former employees. For present employees, the obligations are for both current and past service; for former employees and pensioners, the obligations are for service during their period of employment. These current and past service obligations are settled by annual payments to trustees which are charged to operations.

Income taxes —
Some items of revenue, costs and expenses are recognized for income tax purposes in different years than these items are recorded in the annual accounts. When the cumulative net effect of these timing differences has reduced income taxes otherwise currently payable, the resultant reduction is stated as deferred income taxes on the balance sheet and the tax on the change in timing differences in the year is reflected in the statement of income as deferred income taxes. When net timing differences can only be applied in reduction of income for tax purposes in future years, the tax benefit is recorded in the statement of income as an extraordinary item when realized. Investment tax credits are applied in reduction of the annual provision for income taxes when realized.

2. Net sales:

	1977	1976
	(in thousands)	
Equipment for the transportation industry	$196,090	$170,050
Equipment for the forestry and forest products industries	39,708	29,043
Equipment for the mining industry	54,608	46,820
Shipbuilding and repair	28,071	35,458
Other general engineering and services	44,212	53,710
	$362,689	$335,081

3. Investments:
These are sinking fund debentures issued by Sidbec-Dosco Ltd. (formerly Dominion Steel and Coal Corporation, Limited) carried at cost. At December 31, 1977 the market value of these debentures is estimated to be $2,500,000. Particulars of these debentures are:

Series	Amount (in thousands)	Interest rate	Maturity
"A"	$1,395	5¾%	June 1, 1984
"B"	1,313	6 %	July 15, 1985
"C"	515*	5¾%	July 15, 1985
	$3,223		

*U.S. $480,000

The Company is holding these debentures as long term investments.

4. Fixed assets:

	1977 (in thousands)		1976 (in thousands)	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Land and land improvements	$ 8,150	$ 1,641	$ 7,758	$ 1,519
Buildings	52,287	30,214	48,656	28,882
Equipment	77,061	51,425	72,717	46,360
Railway rolling stock leasing fleet	129,565	50,730	126,678	46,302
	$267,063	$134,010	$255,809	$123,063

5. Patents:
Patent costs relate to the Chip-N-Saw product line and the remaining patent costs were amortized in 1977.

6. Owing to affiliated companies:

The liability to affiliated companies at December 31, 1977 includes advances from the parent company of $3,887,000 (1976 — $3,663,000).

7. Long term debt:

	1977	1976
	(in thousands)	
Canadian General Transit Company, Limited (55% owned) —		
Equipment Trust Certificates		
5¼% — 6¾% due 1978 — 1980	$ 284	$ 596
First Mortgage Sinking Fund Equipment Notes		
5% — 9% due 1978 — 1989 (U.S. $10,175,000)	10,821	11,886
6¾% — 11⅛% due 1978 — 1995	26,607	28,410
First Mortgage Serial Equipment Notes		
6% due 1978 — 1984	805	920
10¼% due in 1978	1,650	1,800
	40,167	43,612
Less — Due within one year included in current liabilities	4,810	3,445
	$35,357	$40,167

Principal payments on long term debt will be as follows:

Year ending December 31	Amount (in thousands)
1978	$ 4,810
1979	3,103
1980	3,046
1981	3,046
1982	3,046
1983—1995	23,116
	$40,167

Railway rolling stock with a net book value of $56,767,000 is pledged by Canadian General Transit Company, Limited as security for its long term debt.

Long term debt payable in foreign currencies translated at historical rates of exchange amounts to $8,677,000 after deducting the portion covered by forward foreign exchange contracts. At the year-end rate of exchange this debt would be $8,802,000.

8. Pensions (See Note 1):

The provision for unfunded pensions of $4,010,000 at December 31, 1977 together with future tax allowances is considered adequate to provide for the cost, based on actuarial computations, of pensions under these unfunded plans. Pension payments, after income taxes, of $455,000 were charged to the provision for unfunded pensions in 1977.

With respect to funded pension plans, the present value of past service obligations to be met, based on actuarial computations, is approximately $14,800,000 at December 31, 1977. These obligations are to be settled by annual payments charged to operations through 1991. During 1977 an amount of $1,646,000 was charged to operations with respect to these obligations.

9. Preferred and common shares:

		(in thousands)
Preferred shares of the par value of $100 each issuable in series —		
Authorized — 250,000 shares		
Issued — 240,000 5¾% cumulative redeemable shares		
Outstanding — 140,000 shares		$14,000
Common shares without nominal or par value —		
Authorized — Class A convertible — 10,000,000 shares		
— Class B convertible — 10,000,000 shares		
Issued and outstanding —		
— Class A convertible —	7,755,555 shares	51,822
— Class B convertible —	373,786 shares	2,498
	8,129,341 shares	54,320
		$68,320

The outstanding preferred shares are redeemable at the option of the Company at $105 per share.

The Class A shares and Class B shares are convertible into one another on a share-for-share basis and rank equally with respect to dividends and in all other respects except that dividends when declared by the Directors on the Class A shares will be taxable dividends, whereas in the case of the Class B shares, the Directors in their discretion, may declare dividends to be paid out of "1971 capital surplus on hand" as defined in the Income Tax Act, Canada. If any dividend is declared on Class B shares, the Directors must declare at the same time a dividend on the Class A shares in an amount equal to the dividend being paid on the Class B shares. Amendments to the Income Tax Act, Canada in December 1977 terminate the right of holders of Class B shares to defer taxation on dividends paid on these shares after 1978.

Total outstanding common shares at December 31, 1977 is unchanged from 1976.

An option to an officer to subscribe for 13,000 unissued Class A shares is outstanding at $3.35 per share expiring in 1979. Exercising this option would have an insignificant effect upon earnings per share.

10. Provision for income taxes:

During the year a subsidiary had a loss and the related unrecorded tax benefit of approximately $960,000 is available for possible reduction of taxation prior to 1983.

11. Special provision:

The extraordinary item of $4,200,000 ($2,586,000 after income taxes and minority interest) relates to the discontinuance of highway trailer manufacturing and ship construction. The charge comprises a provision of $2,370,000, and additional depreciation of $1,830,000 which reduces the book amount of the relevant fixed assets to estimated realizable value.

12. Contingent liabilities:

The Company and subsidiaries are contingently liable (principally for trade notes discounted) in the approximate amount of $3,000,000 (1976 — $3,800,000). Possible losses on claims and suits related to product sales have been provided for in an amount considered to be adequate.

13. Commitments:

At December 31, 1977 expenditures of approximately $6,800,000 are required to complete capital programs. Also, an amount of $18,200,000 including $9,675,000 for the railway rolling stock leasing fleet had been authorized by the Directors but not committed.

14. Anti-Inflation:

The Company is subject to, and believes it has complied with, the anti-inflation legislation enacted by the Federal Government which provides for restraint of prices, profit margins, dividends and employee compensation.

15. Government assistance:

During the year the Company received $4,562,000 under various government assistance programs. Of this sum, $3,867,000 was received under the Shipbuilding Temporary Assistance Program for credit to the purchasers of vessels for the export market, $35,000 was applied in reduction of the cost of fixed assets and the balance of $660,000 was applied in reduction of costs, primarily for product development. Government assisted programs are proceeding in accordance with their respective terms and no liability for repayment of such assistance under various contingency clauses is foreseen.

16. Remuneration of directors and officers:

For the year 1977 six directors and one past director received remuneration of $33,542 (1976 — $33,246) and seven directors and one past director received no remuneration as directors. Twelve officers, of whom seven are also directors, and three past officers received remuneration of $674,496 (1976 — $621,157).

Auditors' Report

To the Shareholders of
Hawker Siddeley Canada Ltd.:

We have examined the consolidated balance sheet of Hawker Siddeley Canada Ltd. as at December 31, 1977 and the consolidated statements of income and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse & Co.
Chartered Accountants

Toronto, Ontario,
March 16, 1978

Miscellaneous Data on Sales, Employees, and Shares

	1977	1976
Sales ($000):		
By Canadian factories —		
to Canadian markets	$217,088	$220,579
to Export markets	86,497	61,301
	303,585	281,880
By foreign subsidiaries (excluding sales of products of Canadian factories)	59,104	53,201
	$362,689	$335,081
The average weekly number of employees and their remuneration was as follows:		
in Canada	6,298	6,786
in the United Kingdom	709	679
in the United States of America and other countries	90	89
	7,097	7,554
Aggregate remuneration of employees was ($000)	$121.268	$118,880

Common share dividends for 1977 have been declared as follows:

Record Date	Payable	
December 30, 1977	January 20, 1978	$ .10
September 23, 1977	October 14, 1977	.09
June 24, 1977	July 15, 1977	.09
March 25, 1977	April 15, 1977	.09
		$ .37

Preferred share quarterly dividends of $1.4375 were paid on the 2nd day of January, April, July and October, 1977.

The Department of National Revenue has published the following "Valuation Day" share prices (December 22, 1971) for income tax purposes:

Preferred shares	$58.50
Common shares	$ 2.40

Divisions and Subsidiaries

Divisions:
Canadian Car Division, Thunder Bay, Ont.
Can-Car Trailer Division, Mississauga, Ont.
Canadian Car (Pacific) Division, Surrey, B.C.
Canadian Steel Foundries Division, Montreal, Que.
Canadian Steel Wheel Division, Montreal, Que.
Forestry Equipment Division, Mississauga, Ont.
Orenda Division, Mississauga, Ont.

Subsidiaries:
Can-Car Inc., Atlanta, and Waycross, Ga., McComb., Miss., U.S.A. (100%)*
Chip-N-Saw, Inc., Atlanta, Ga., U.S.A.
The Dosco Corporation, Pittsburgh, Penn., Denver, Col., U.S.A.
Chip-N-Saw A/S, Naestved, Denmark (100%)*
Orenda Engines Inc., Buffalo, N.Y., U.S.A. (100%)*
Orenda (International) Limited, Mississauga, Ont. (100%)*
Hawker Industries Limited, Toronto, Ont. (99%)*
Canadian Bridge Division, Windsor, Ont.
Halifax Shipyards Division, Halifax, N.S.
Trenton Works Division, Trenton, N.S.
Dosco Overseas Engineering Limited, Tuxford, England
Hollybank Engineering Company Limited, Tuxford, England.
Canadian General Transit Company, Limited, Montreal, Que., Toronto, Ont., Moose Jaw, Sask., Red Deer, Alta. (55%)*

**percentage control by Hawker Siddeley Canada Ltd.*

Products and Services

Equipment for the transportation industry:
Canadian Car Division
Can-Car Trailer Division
Canadian Steel Foundries Division
Canadian Steel Wheel Division
Trenton Works Division
Canadian General Transit Company, Limited
Railway passenger cars (subway, commuter, and inter-city); highway trailers; railway castings; trackwork; railway and industrial wheels; railway freight cars and tank cars; railway axles; forgings; storage and pressure tanks; steel fabrications; railway tank car and special freight car leasing; bulk liquid storage terminals.

Equipment for the forestry and forest products industries:
Canadian Car (Pacific) Division
Forestry Equipment Division
Can-Car Inc.
Chip-N-Saw A/S
Chip-N-Saw, Inc.
Log skidders and other forest harvesting equipment; sawmill and lumber processing equipment; electric-electronic control equipment.

Equipment for the mining industry:
Dosco Overseas Engineering Limited
Hollybank Engineering Company Limited
The Dosco Corporation
Canadian Steel Foundries Division
Mining and tunnelling machines; support systems for mining roadways and civil engineering tunnels; castings for the mining industry.

Ship repair:
Halifax Shipyards Division
Ship repair; marine services including dry docking.

Other general engineering and services:
Canadian Bridge Division
Canadian Steel Foundries Division
Orenda Division
Orenda Engines Inc.
Orenda (International) Limited
Electric power transmission towers, poles, and structure testing; communications structures; sub-station structures; industrial castings; electronic data processing and graphics services; industrial gas turbines; gas turbine components; aircraft gas turbine repair and overhaul; components for nuclear power applications; engineering, design and laboratory testing services.

Hawker Siddeley Canada Ltd.

Head Office
7 King Street East,
Toronto, Ontario
M5C 1A3

Directors
A.A. Bailie, Toronto, Ontario
J.H. Coleman, Toronto, Ontario
A.H. Crockett, Toronto, Ontario
R.S. Faulkner, Toronto, Ontario
Sir Arnold Hall, London, England
J.F. Howard, Q.C., Woodbridge, Ontario
A.J. Laurence, Pewsey, Wiltshire, England
A.W. McKenzie, Montreal, Quebec
L.A. Mitten, Vancouver, British Columbia
J.N. Paterson, Thunder Bay, Ontario
K.L. Phillips, Sutton, Surrey, England
E.J. White, St. Lambert, Quebec
F.H. Wood, Barrow-upon-Soar, Leicestershire, England

Executive Management
Sir Arnold Hall, Chairman
J.N. Paterson, Vice-Chairman
F.H. Wood, Vice-Chairman
R.S. Faulkner, President and
Chief Executive Officer
A.A. Bailie, Vice-President, Finance
I.E. Bull, Vice-President and Treasurer
J.W.R. Caldwell, Comptroller
L.T. Corey, Vice-President
(Halifax Shipyards and Trenton Works Divisions)
C.A. Haines, Secretary
A.W. McKenzie (Chairman and President,
Canadian General Transit Company, Limited)
L.A. Mitten, Vice-President
(Canadian Car (Pacific) Division)
F.J. Sandford, Assistant Treasurer
R.F. Tanner, Vice-President
(Orenda and Can-Car Trailer Divisions)
E.J. White, Vice-President
(Canadian Steel Foundries and
Canadian Steel Wheel Divisions)

Auditors
Price Waterhouse & Co.,
Toronto, Ontario

Registrar and Transfer Agent
National Trust Company, Limited
Toronto, Montreal, Winnipeg and Vancouver

A mid-level compartment in the new 162-seat, double-deck rail commuter cars designed and built by Canadian Car Division. Stairs from the lower deck are on the left; those in the centre lead to the upper deck.

A Forwarder chassis supplied by the Forestry Equipment Division is the basis of this fire-fighting unit, one of three exported to Senegal for brushwood and forest fire control.

SEDCO/BP 471, a 470-foot drill ship constructed by Halifax Shipyards Division is equipped with a dynamic positioning system capable of maintaining the vessel over a predetermined point while drilling in water depths up to 6000 feet.

DESIGNED AND PRINTED IN CANADA BY HAWKER SIDDELEY GRAPHICS

AR01

Hawker Siddeley Canada Ltd. and subsidiary companies

Consolidated Statement of changes in financial position for the six months ended June 30

	1977	1976
	(In Thousands of Dollars)	
Source of working capital:		
Net income for the period	**$ 5,131**	$ 3,298
Charges to income not affecting working capital — (mainly depreciation, amortization of patents, deferred income taxes and interest of minority shareholders in income of subsidiaries)	**6,541**	6,112
Working capital provided from operations	**11,672**	9,410
Proceeds on disposal of fixed assets	**564**	447
	12,236	9,857
Application of working capital:		
Additions to fixed assets	**4,771**	4,170
Reduction of —		
Long term debt	**967**	1,628
Provision for unfunded pensions	**232**	195
Dividends declared payable to —		
Shareholders of Hawker Siddeley Canada Ltd.	**1,866**	1,866
Minority shareholders of subsidiaries	**437**	396
Miscellaneous	**4**	—
	8,277	8,255
Working capital:		
Increase for the period	**3,959**	1,602
At beginning of year	**48,607**	45,352
At end of period	**$52,566**	$46,954

CHANGES IN ELEMENTS OF WORKING CAPITAL

	1977	1976
Current Assets — Increase (Decrease)		
Cash	**$ (9,236)**	$ 447
Accounts receivable	**9,979**	1,922
Income taxes recoverable	**217**	—
Inventories	**9,200**	4,468
Prepaid expenses	**1,025**	1,505
	11,185	8,342
Current Liabilities — Increase (Decrease)		
Bank advances	**(9,172)**	11,993
Accounts payable and accrued liabilities	**10,124**	(1,209)
Income and other taxes payable	**2,880**	463
Advances on sales contracts	**7,109**	(5,267)
Long term debt due within one year	**(84)**	577
Owing to affiliated companies	**(3,631)**	183
	7,226	6,740
Increase in working capital for the period	**$ 3,959**	$ 1,602

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Hawker Siddeley Canada LTD.

Semi-annual report for the period ended June 30, 1977

7 King Street East,
Toronto, Ontario, M5C 1A3

To the Shareholders:

Your Directors submit herewith the unaudited consolidated statements of income and changes in financial position for the six months ended June 30th, 1977, together with comparable figures for the same period last year.

The increase in sales to $182 million ($165 million in 1976) was due principally to high volume deliveries of passenger rail cars, partially offset by a lower volume of freight cars. There was also some improvement in forest products but sales of steel castings were at a lower level.

The net income for the period was $5.131 million ($3.298 million in 1976) which is the equivalent of 58 cents per common share (36 cents in 1976). Net income includes an exchange gain of $0.797 million (against a loss in 1976 of $1.646 million) in respect of the translation of the accounts of foreign subsidiaries.

There are now signs of improvement in demand for forest products, steel wheels, aero-engine and mining equipment. The award of a $39.6 million contract to construct 190 light rail vehicles designed by the Ontario Urban Transportation Development Corporation for the Toronto Transit Commission was recently announced. No significant upturn in demand for freight car equipment is expected in the immediate future and there will be a decline in activity at the Halifax Shipyard with the completion of a major contract later this year.

Negotiations on new labour agreements are currently in progress at Thunder Bay, Trenton and Forestry Equipment Divisions.

On August 17, 1977, a quarterly dividend of 9 cents per common share was declared payable on October 14, 1977, to shareholders of record on September 23, 1977.

Submitted on behalf of the Board,

J.N. Paterson,
Vice-Chairman

R.S. Faulkner,
President and Chief Executive Officer

Toronto, Ontario, August 17, 1977.

Hawker Siddeley Canada Ltd. and subsidiary companies

Consolidated statement of income for the six months ended June 30

	(In Thousands of Dollars) 1977	1976
Revenue:		
Net sales	**$ 182,896**	$ 165,434
Income from investments	**684**	233
	183,580	165,667
Costs and expenses:		
Cost of sales, selling, general and administrative expenses exclusive of the following	**165,452**	146,287
Interest on short term borrowings	**308**	1,227
Interest and amortization of costs of long term debt	**1,912**	2,168
Provision for depreciation	**5,403**	5,365
Amortization of patents	**150**	150
	173,225	155,197
Income from operations before income taxes	**10,355**	10,470
Provision for income taxes — Current	**4,575**	4,849
— Deferred	**837**	103
	5,412	4,952
	4,943	5,518
Interest of minority shareholders in income of subsidiaries	**609**	574
Income before exchange gain (loss)	**4,334**	4,944
Exchange gain (loss) on the translation of the accounts of foreign subsidiaries	**797**	(1,646)
Net income for the period	**$ 5,131**	$ 3,298
Earnings per common share	**58 cents**	36 cents

Notes:

1. Interim statements are not audited and are subject to year-end adjustments.
2. A proposed amendment to the Income Tax Act (Canada) to permit a deduction from taxable income based on the cost of opening inventories, if implemented, will reduce the provision for income taxes applicable to the six months by approximately $300,000.